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Thailand's Export Drive: The Risk and the Promise

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An Intelligence Assessment

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Thailand's Export Drive: The Risk and the Promise [redacted]

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An Intelligence Assessment

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Thailand's Export Drive: The Risk and the Promise 25X1

Key Judgments

Information available as of 30 March 1985 was used in this report.

Over the past year the Prem government has made a good start implementing a program to ease the troublesome trade deficit and boost Thai export competitiveness—especially of manufactures. The program has the potential to diversify the composition of exports away from traditional commodities—which still account for 60 percent of export earnings—toward labor-intensive manufactures and processed resources. 25X1

In pursuing its export drive we believe Bangkok will become more contentious on international economic issues of interest to Washington, although not to the point of seriously impairing the overall US-Thai relationship. A number of Thai officials believe that Bangkok deserves special treatment from Washington on economic issues because of the close bilateral relationship, according to the US Embassy, and they can be expected to press their case. Bangkok will also be more likely to join with other East Asian exporters in urging improved market access. 25X1

Opposition to the export reform effort from Thai interest groups may delay some aspects of the program but is unlikely to derail it. Prime Minister Prem's political position is strong. He retains the support of an increasingly influential corps of economic technocrats, and he has demonstrated his willingness to make tough economic decisions in the face of substantial political outcry. 25X1

The government's politically controversial reform program aims at making production for export more profitable by:
- Maintaining a realistic exchange rate.
- Encouraging foreign investment in export-oriented industries.
- Slowing foreign borrowing to maintain Thailand's good international credit rating.
- Accelerating financial liberalization to increase domestic saving and investment. 25X1

Assuming the Thai fully implement the export reform package and the world economic recovery continues, we believe that export earnings are likely to grow 10 to 15 percent annually through 1990. Most of the gains will come from the United States and Western Europe. This would be enough to ease Bangkok's recent balance-of-payments strains and would also allow it to avoid a foreign debt crisis later in the decade—a prospect that has government technocrats very concerned. 25X1

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Thai Exports of Manufactures

Bangkok's shift in the late 1960s from an inward-looking import substitution policy to a more open, export-oriented development strategy stimulated a rapid expansion of manufactures exports. By 1984 manufactures accounted for about a third of total export earnings, but import tariffs and other protective measures adopted in the mid-1970s reduced the relative profitability of producing for export.

Textiles and garments *provide about a fourth of the earnings from manufactures exports, reaching about $700 million last year. Because the textile sector now suffers from excess capacity, Bangkok is encouraging the industry to move to higher value-added garment production such as designer labels. About three-fourths of the sector's export earnings now come from garments.*

Integrated circuits and electronic components *are the most promising category of manufactures exports. US-based National Semiconductor set up operations in 1973, followed by other US firms—Signetics, Honeywell, and Data General. Exports of integrated circuits in 1984 totaled about $350 million. Although Thailand's electronics industry—employing only 12,000 people—is small compared with that in other Asian countries, it is growing rapidly. Several of the existing firms are expanding operations, another US firm recently decided to open a plant near Bangkok, and several US and Japanese companies are studying the possibility of investing in Thailand, according to the financial press.* 25X1

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Processed food *is a small, but rapidly growing foreign exchange earner:*

- *Canned seafood, mostly tuna, accounts for over 6 percent of manufactures exports. By 1982 Thailand was a major exporter of canned tuna. Approximately half of Thailand's tuna exports go to the United States.* 25X1
- *Canned pineapple, produced largely by US-based Castle and Cook, provides about 4 percent of earnings from manufactures exports. Thailand recently surpassed Hawaii to rank number two in canned pineapple exports, about half of which go to the United States.* 25X1

[redacted] 25X1

Thailand's Export Drive: The Risk and the Promise [redacted] 25X1

Lagging Export Performance

Prime Minister Prem Tinsulanonda, in his strongest political position since taking office in 1980, has a unique opportunity to enhance Thai export competitiveness and ease the country's troublesome balance-of-payments strains. [redacted]

Thailand's once promising export growth has slowed markedly since 1980. Export earnings increased at an annual rate of about 5 percent during the period 1980-83, compared with a 25-percent annual rise in the 1970s. Although export volumes rose substantially in the past few years, the prices of Thailand's principal commodity exports—rice, rubber, tin, and sugar—fell sharply in the 1981-82 global recession and remain depressed. Export performance in 1983 was especially disappointing because earnings fell by 7 percent at a time when neighboring countries were boosting foreign sales. [redacted]

The growth of manufactured exports,[1] which had soared from a negligible $43 million in 1970 to $1.7 billion in 1980, also slowed sharply. World Bank, IMF, and private Thai economists attribute this slowdown to depressed world demand and domestic economic inefficiencies, such as rigid interest rates and increased tariff protection that weakened Thai export competitiveness after the mid-1970s. According to several studies, Thailand moved from a relatively low level of import protection in 1970 to a relatively high level of protection by the end of the decade.[2] Moreover, an overvalued currency—which had been pushed up sharply in recent years by its link with the US dollar—boosted prices of Thai manufactures, especially in Japan and Western Europe. [redacted]

[redacted] Thai policymakers have been increasingly concerned in recent years about poor export performance and its effects elsewhere in the economy. They are worried about the sharp rise in the debt service ratio from 10 percent in 1980 to 22 percent last year as foreign exchange available from exports failed to keep pace with rising debt obligations.[3] They are also concerned that the sharp decline in Thailand's international terms of trade has contributed to a marked slowdown in the growth of real income, [redacted] This factor, along with population growth of about 2 percent a year, means that the quantity of goods and services available to the average Thai has increased only slightly in the 1980s despite economic growth averaging about 6 percent annually.[4] [redacted]

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Thailand's recent disappointing export performance coincided with a credit-driven import boom to produce a record current account deficit of $3 billion in 1983, a trend that continued through early 1984.[5] These balance-of-payments difficulties generated public speculation of a currency devaluation and runs on the country's foreign exchange reserves. Bangkok's initial response was to slow the import boom by restricting the growth of the money supply, beginning in late 1983. The resulting high interest rates and credit rationing, however, generated a politically controversial wave of small business bankruptcies and a liquidity crisis in the financial sector. The tight money policy also helped hold the rate of economic growth to 5.8 percent in 1984, well below government projections. [redacted]

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[1] Exports of manufactures include processed agricultural and mineral products as well as canned pineapple and tuna. [redacted]

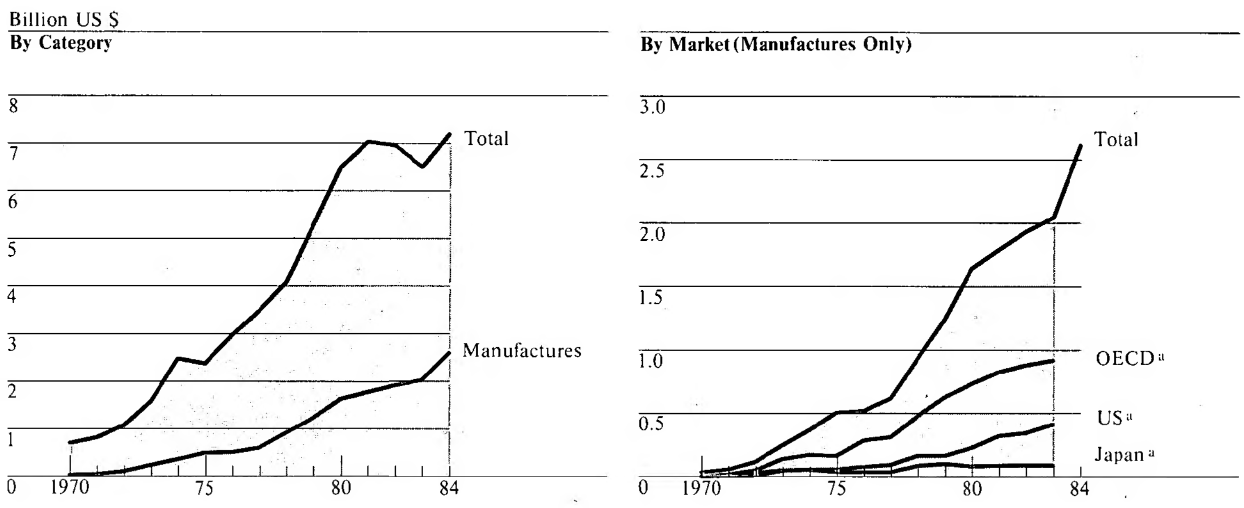
[2] The average rate of effective protection—which measures how well a country's tariff structure protects its labor and capital resources—rose from 40 percent in 1974 to 70 percent in 1978, and the effect on exports moved from moderately encouraging to moderately discouraging, according to several economic studies. [redacted]

[3] The debt service ratio is the ratio of interest and principal payments on foreign debts due for one year to export earnings for that year. [redacted]

[4] [redacted] the decline in Thailand's commodity terms of trade—which is a ratio of export prices to import prices—has offset about half of real GDP growth since 1980. [redacted]

[5] The current account measures the balance of trade in goods, services, and financial transfers and is the best indicator of a country's need for foreign capital. [redacted]

Thailand: Growth of Export Earnings, 1970-84



[a] Excluding processed food. 1984 data are not available.

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The New Export Strategy

The Prem government responded to the growing external financial difficulties by launching a forceful campaign to reduce the trade deficit in the short run and boost Thai export competitiveness—especially for manufactures—in the long run. The government's export program, modeled after a proposal made early last year by the prestigious Bangkok Bank, is intended to shift resources into export industries and away from the production of import-competing goods for the domestic market (see table 1). 25X1

Encouraging Progress So Far

Bangkok has moved quickly to implement parts of this program. The most surprising move occurred last November when the government devalued the baht by 17 percent against the US dollar and announced that the baht would henceforth float against a market basket of trading partner currencies. Prem was able to defuse the public outcry and pressure from influential military figures through skillful maneuvering and the support of key technocrats and the palace.[6] 25X1

To prevent sharp increases in the government's budget deficit from undermining the devaluation, Bangkok quickly heeded World Bank and IMF advice to impose economic austerity measures. The Cabinet late last year approved sharp budget cuts and postponed "nonessential" development projects. It also reduced the 1985 ceiling on government-guaranteed foreign loans by 30 percent to $1.6 billion. Further budget cuts and substantial tax increases probably will be introduced in the National Assembly session that begins in April. The debate over the proposed economic reforms promises to make that session stormy. 25X1

[6] Several military figures and politicians suffered financial losses from the devaluation, according to press reports. 25X1

Structural Reforms

We believe the Prem government is now committed to accelerating the implementation of longer term reforms begun in 1982 under the auspices of a $350 million loan from the World Bank. The measures would decrease the level of tariff protection and increase the openness of the economy to international trade.[7] [redacted]

Once these reforms are implemented, Bangkok intends to limit its role in export promotion to channeling credit to export-oriented firms, maintaining a realistic currency value, and improving the marketing of potential Thai exports. The government is then counting on the dynamic and adaptable Thai private sector to respond to the heightened export incentives. We do not believe Bangkok will attempt to set up government-sponsored international trading companies after the failure of its previous attempt in 1981. [redacted]

The Obstacles Ahead

The government will have to tread carefully if it hopes to achieve most of these reforms over the next two years. Influential elements in the military and the opposition Thai Nation Party (TNP) have vested interests in the current economic structure, which favors production of manufactures for the domestic market rather than for the highly competitive export market. Both groups have in the past successfully manipulated public discontent over economic policy to force the government to back down from reform. [redacted]

Recently, moreover, military figures and opposition politicians—along with some Thai academics—have begun to cite the changing world economy as demonstrating the futility of the government's export drive. They argue that the Thai economy would grow faster by concentrating on the domestic market rather than by trying to increase exports to slowly growing industrial economies. [redacted]

As the National Assembly session approaches, the TNP—which hopes to gain a role in the government—is stepping up its attack on Prem's economic management. We believe the most vulnerable area of the government's export strategy is its economic austerity policy. The TNP is especially critical of Finance Minister Sommai for the devaluation-induced rise in inflation and for the recently proposed large tax hike. Influential military officers, occasionally in concert with the TNP, have criticized plans for budget austerity and complained bitterly about limits on foreign borrowing restricting military purchases abroad. In addition, plans to sell some state enterprises to the private sector or cut subsidies to some of them are drawing opposition from public-sector unions—the country's largest—and senior military officers who frequently sit on the boards of directors. [redacted] 25X1 25X1

What Is Different This Time? 25X1

Although much of the rhetoric about improving the competitiveness of Thai exports by increasing the openness of the economy and adopting stringent budget cuts is old hat in Bangkok, we are moderately optimistic about the outcome of this program. The influence of well-trained Thai technocrats on economic policy—steadily growing for a decade—has accelerated under Prem as has the centralization of economic policymaking. In addition, the Prime Minister has shown increased willingness to implement difficult economic decisions, including doubling domestic energy prices in 1981-82 and sharply devaluing the currency last fall. The Cabinet's approval of a partial tax increase package early this month, while postponing some controversial tax hikes, contained measures favorable to exports. [redacted] 25X1 25X1

Both Prem and the technocrats, moreover, seem determined to avoid an international debt crisis such as that in the neighboring Philippines. The sudden realization last winter that the domestic budget deficit was much larger than previously thought also stiffened the government's resolve to implement the proposed reforms. [redacted] 25X1 25X1

[7] Bangkok's proposed tariff reforms would lower tariffs on the import of final products while increasing them on intermediate goods. [redacted] 25X1

Table 1
Status of Economic Reforms

Reform	Objective	Status/Prospects	Comments
Currency reform	Develop an exchange rate system that closely reflects resource costs of imports and exports.		
Devaluation Managed float		Currency devalued from 23 to 27 baht per US dollar in November. Now pegged to market basket of trading partner currencies, with US dollar influence substantially reduced. Baht continued to depreciate in March.	Ability of Bank of Thailand to adjust currency value frequently to reflect economic changes key to future export competitiveness.
Rationalization of domestic export/import price structure	Reduce level of import protection to industry, promote domestic efficiency, increase international competitiveness of export sector.		
Reduction or removal of protective tariffs on finished goods; increase on intermediate goods		Overall level of effective protection lowered to approximately 40 percent in 1982. Some tariffs and quotas eliminated.	Could be reversed if trade deficit does not improve.
Reduction or elimination of subsidies to exporters		Eliminated for textile exports to the United States under agreement with US Department of Commerce. Cuts in subsidies to other exporters uncertain.	Reduction or elimination of other subsidies is likely to provoke opposition from manufacturers and exporters.
Financial system reform	Increase domestic savings, channel into export-oriented investment, reduce need for foreign borrowing.		
Reduction in size of informal financial sector		Royal decree bans "chit funds" as of November 1985. Funds gradually deflating in early April.	Involvement of senior military officers makes issue highly sensitive.
Tighter regulation of nonbank finance companies		Government's "lifeboat scheme" has bailed out ailing companies with additional funds and closer regulation.	Many are still weak and a liquidity crunch could cause additional failures.
Increased equity financing for investments	Decrease dominant role of bank financing of new firms.	Securities Act amended last fall to permit listed companies to make public offerings of shares and debentures.	Higher returns available from informal financial sector will retard equity formation.
Liberalization of interest rates		Interest rates increased last year for some types of deposits. Lending rates raised for nonpromoted projects.	Private banks still reluctant to change interest rates to reflect credit conditions without pressure from Bank of Thailand.
Export promotion measures	Reduce trade deficit, create jobs, boost labor- and resource-intensive exports, reduce foreign borrowing.		
Foreign investment incentives		On paper Bangkok offers a competitive package of incentives and has over the past two years begun sending missions abroad to recruit foreign investment.	Redtape, bureaucratic delays, fear of Indochina conflict remain barriers.

Table 1 (continued)

Reform	Objective	Status/Prospects	Comments
Export incentives		Incentives include export credits, tax holidays, and promotional measures. A national export plan incorporating production, marketing, and financial incentives is under discussion.	Attempt in 1980-81 to set up Japanese-style marketing cartels (sogo soshas) failed. Little progress so far in setting up export processing zones.
Fiscal reform	Reduce government budget deficit and need for foreign borrowing to finance current consumption rather than longer term investment.		
Budget austerity		Budget cuts of 5 to 10 percent for FY 1985 have been implemented and other measures approved to curtail government spending. Wage freezes for many government employees are likely over the next two years. "Zero Growth" budget may be proposed for fiscal 1986.	Military is pressing for additional funds. Labor groups are likely to add to pressure against austerity measures.
Restructuring of tax system		Indirect taxes increased, personal income taxes for lower tax brackets reduced. Major tax increases under consideration.	Despite reform, Thailand is expected to face a $1.8 billion revenue shortfall in FY 1985. Cabinet in early April approved part of Sommai's tax increase package.
Rationalization of state enterprise sector	Make public sector a net contributor to national savings. Reduce public-sector foreign borrowing.		
Privatization of unprofitable state enterprises		Government still debating which firms will be sold off. Has stated that it will continue to run those enterprises that are considered vital to the country, even if they are operating at a loss.	Employees of enterprises certain to oppose these measures. Workers of Communications Authority of Thailand struck for two days in February to protest planned privatization, other strikes possible. Opposition from military also is likely because senior officers often supplement incomes with directorships of state enterprises.
Increased fees for public utilities and services		Busfare increased by a third in February. Fees for other services and utilities probably will also be increased.	Issue has been politically sensitive in the past, but public reaction to current increases has been minimal so far.
Administrative reform	Streamline and improve economic planning and resource mobilization.		
Centralization of economic decision making		Minister of Finance Sommai, trusted by Prem, is now most influential economic policy maker. Council of Economic Ministers is gaining influence.	Not formalized, although technocrats are gaining power. Too early to assess role to be played by government's new economic think tank, Thailand Development Research Institute.
Reduction of redtape, corruption		Foreign investment, export procedures being streamlined. The Board of Investment's One-Stop Investment Center has made small but definite improvement, according to US businessmen.	Conflicting signals to investors are likely to continue as long as various ministries and agencies retain a large degree of autonomy.

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The National Assembly session should provide an early indication of the prospects for reform. In our view, Prem—whose political strength has been increasing—has a better than even chance over the next two years of accomplishing substantial reform and thereby improving export performance [8] (see appendix). [redacted]

Trade Prospects in 1985

The continuing world economic recovery probably will assure modest expansion of export earnings this year regardless of the outcome of the reform effort. Although the value of sugar and tin exports will be held down in 1985 by low prices and international quotas and rice export volumes will at best hold steady, other commodities should benefit from increased volumes. Bangkok, moreover, scored a coup last month when the USSR agreed to buy 500,000 tons of tapioca pellets this year. Exports of manufactures and processed food products, which soared late last year, probably will experience another year of at least modest growth, especially if economies in Japan and Western Europe—which together take half of Thai exports—accelerate. [redacted]

The currency devaluation probably will also provide a strong boost to exports by yearend, especially if the value of the US dollar remains high. Despite domestic opposition, the Bank of Thailand has allowed the baht to depreciate further against the dollar in the past few months, making Thai exports even cheaper abroad. The devaluation and limits on foreign borrowing should also slow the growth of imports, easing Bangkok's external finances. We expect the current account deficit to fall by about $500 million this year to $1.8 billion. [redacted]

Looking Further Ahead

We believe Thai exports may grow more strongly in the next few years. If industrial countries experience strong economic growth—4 to 5 percent a year, we expect Bangkok's export earnings to grow by 10 to 15 percent annually through 1990. This is below the rate of the 1970s but high enough to ease Bangkok's recent balance-of-payments strains and maintain Thailand's good international credit rating. A revival of international commodity prices would accelerate growth even more. Even in a relatively unfavorable world economic situation of slow economic growth and growing protectionism, we believe Thailand's market-oriented openness, enhanced by current reforms, probably will result in a relatively strong performance compared with other developing countries. [redacted]

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We expect a boost in Thai exports in traditional commodities and manufactures. The commodity sector retains the capacity to expand the export volumes of rice, rubber, corn, and other products to offset continuing low commodity prices, [redacted] In recent years, the Thai private sector has demonstrated the ability to export higher valued agricultural products, especially rice, by improving processing and marketing, according to industry sources. [redacted] the export of processed food and raw materials can be stepped up substantially. [redacted]

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If the foreign investment process remains relatively open and bureaucratic procedures are streamlined, we believe Thailand will attract additional firms in electronics and other export-oriented industries moving away from higher wage Asian producers.[9] Bangkok, moreover, has recently indicated it may require future Japanese foreign investment—now producing almost entirely for the domestic market—to be more export oriented. International commercial banks continue to rank Thailand among the most creditworthy developing countries because of its traditionally conservative financial management and the declining attractiveness of other borrowers (see table 2). Prem's campaign to publicize Thailand's economic and political stability appears to be working despite renewed and more serious fighting along the Thai-Cambodian border. A number of favorable articles about Thailand have appeared in respected international financial publications over the past year. [redacted]

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[9] Bangkok has made some progress in eliminating redtape and improving the bureaucracy's responsiveness but still has a way to go, according to US businessmen. [redacted]

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[redacted]

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We do not believe that growing international protectionism poses a severe obstacle for Thai exports. Aside from tin, sugar, and tapioca, Thailand's traditional exports do not face quota restrictions, nor do Thai-manufactured items except for textiles and garments. Even in textiles, Thailand is only beginning to meet its quota limits in many categories. Nontariff barriers such as health and safety regulations in industrial countries pose more substantial barriers to Thai agricultural and resource-based exports. Nonetheless, Thailand has already demonstrated the ability to improve the processing of rice and frozen seafood destined for the US market.

The emergence of China as a low-cost export competitor in both agricultural commodities and textiles may be more troublesome for Thailand than protectionism. China has already taken about 15 percent of Thailand's export market for corn in Asia in the past year because of lower prices and better quality. Bangkok is also concerned about a Chinese threat to its low-quality rice sales, although Thailand is almost certain to retain the high-quality rice market. China has also

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begun to undercut Thai sales in cheap, basic garments in the US and Canadian markets by offering lower prices and shorter delivery times. Bangkok may thus lose out in textiles and other areas to competitors such as China and possibly Indonesia but, in our judgment, is probably adaptable enough to develop other product lines for export. [redacted]

Implications for the United States

Bangkok's export drive may strain cordial US-Thai commercial relations. The United States has been able to count on Thailand as a supporter or at worst a mild opponent in various international commodity agreements. Bangkok, for example, has been very cooperative in the current round of negotiations for a new international rubber agreement. [redacted]

Although we do not believe the overall US-Thai bilateral relationship will be seriously impaired, we expect the Thai to be more contentious about international economic issues in the future, as they move to increase and diversify exports. A number of Thai officials, moreover, apparently believe Thailand deserves special treatment from the United States on economic issues because of this close relationship and are hurt when it is not forthcoming. Bangkok carried this belief into last winter's negotiations on the US imposition of countervailing duties on Thai textile exports, according to the US Embassy. [redacted]

In particular, Bangkok will be more likely to:
- Support Malaysia on international commodity issues, especially those involving rubber and tin.
- Join with other East Asian exporters in pressing for improved market access.
- Object more strongly to US health and administrative regulations that restrict Thai products such as rice and seafood. [redacted]

Maintaining a more realistic currency value and improving incentives, moreover, probably will boost export of commodities directly competitive with US products such as rice, corn, and canned pineapple. The devaluation has already allowed Thailand—the world's largest rice exporter—to reduce effective export prices by about $35 a ton since the beginning of the year. [redacted] this has further undercut sales by the United States, Thailand's major competitor in the world rice market. [redacted]

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Thai exporters probably will apply the lessons learned in price cutting and extension of trade credits to other products such as corn and tapioca—which compete with US exports as animal food. Over the next few years we are also likely to see relatively large increases in Thai sales of electrical appliances, toys, shoes, and other labor-intensive items to the United States as the Thai try to gain a piece of the market now largely held by South Korea, Taiwan, and Hong Kong. Thai exports of most of these products are now so small that relatively large increases could occur without risking US protective measures and the same is true in Western Europe. [redacted]

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Appendix

What if Economic Reform Stalls?

Much of our optimism about Thailand's export prospects is based on Prem's public and private support for the necessary economic reforms. We believe that Finance Minister Sommai—although a key figure in the export drive—is more expendable than Prem and could be sacrificed without permanently impeding reform. Thailand has several capable technocrats who can replace Sommai, but we know of no other figure with the standing to generate the broad, long-term support the export campaign needs. If Prem resigns for health reasons, is forced from office, or looses his parliamentary majority, the outlook for Thai economic reform becomes more doubtful. There are two possible changes in the government in the near term that would cause us to downgrade our assessment of Thailand's export prospects.

If the TNP becomes part of the governing coalition—and especially if it should gain the prime-ministership, we believe the export drive will stall. The TNP's less disciplined politicians, strong links to domestic manufacturing interests, and propensity for shady deals would almost certainly derail the reforms. The son of the deputy TNP leader, who is an academic economist, moreover, is an increasingly prominent advocate of the view that international protectionism will limit any Thai export drive.

We believe export prospects would also dim if a military-dominated government headed by Army Commander in Chief General Arthit, frequently mentioned as Prem's most likely successor, comes to power. General Arthit has demonstrated little understanding of economic affairs, a fact that did not prevent his clumsy and unsuccessful efforts to reverse last year's devaluation. He has bitterly criticized the government's budget cuts and the ceiling on foreign borrowing that restricts military purchases abroad. In addition, some of Arthit's closest advisers have long advocated increasing the economic role of the government—especially in banking and international trade.

A TNP government or one headed by Arthit (or a possible combination of the two) would be less likely to:
- Implement budget austerity measures.
- Curb foreign borrowing.
- Reduce the size of the public sector.
- Reduce tariffs and other barriers to trade.
- Encourage foreign investment.

Such an economic policy would probably lead to stagnant export earnings and accelerated foreign borrowing even in a favorable global economic environment. 25X1

Nonetheless, as long as the government allows the private sector room to operate, the Thai economy—on the strength of its dynamic agricultural sector and growing natural gas production—would probably be able to avoid severe balance-of-payments problems. In the face of a sharp decline in export earnings associated with a major global recession, however, Thailand would almost certainly face an international debt crisis. 25X1

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